Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Developing a Unified Intercarrier Compensation Regime	CC Docket No. 01-92

REPLY COMMENTS OF VERIZON

Edward Shakin
John M. Goodman

Michael E. Glover
Of Counsel

Attorneys for Verizon

1300 I Street, NW
Suite 400 West
Washington, DC 20005
(202) 515-2563

November 5, 2001

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Summary

The Commission should act promptly to put an end to two abuses that have discouraged facilities-based local competition and encourage inefficient behavior. First, it should confirm that carriers may not obtain telephone numbering resources for a geographic area in which the carrier has no facilities and no prospect of any local service customers. In doing so, it should make clear that carriers may not use telephone numbers to steal transport services from one LEC in order to provide an interexchange service disguised as local. Second, it should accelerate the transition to bill and keep for calls to the Internet.

Much of the debate in the comments was over the use of some form of bill and keep for interconnection compensation for local and CMRS calls. Verizon believes that the simplicity of that arrangement could make it appropriate and beneficial for this purpose. Eliminating compensation payments will also eliminate the possibility of other abuses that are based on the receipt of reciprocal compensation for local calls. If the Commission elects to retain some form of payment, it should not base it on TELRIC. TELRIC costs are not appropriate for compensation under section 252(d)(2)(A)(ii), as they do not result in compensation for the "additional costs of terminating a local call."

As a necessary part of a bill and keep approach, the Commission should adopt new default interconnection point rules. A clear statement of what the arrangements will be in the absence of a negotiated agreement will provide certainty and reduce disputes and litigation. These new default rules should recognize the telecommunications networks that exist today, those of the ILECs, CLECs and CMRS providers, and should provide for an equitable apportionment of transport costs. Under such a compromise, the new interconnection point would be the same regardless of which way the traffic was flowing. Carriers that make choices of network architectures should receive the benefits and bear the costs of those choices.

For these reasons, Verizon proposes that the bill and keep default interconnection point be at the wire center that contains the highest point of switching in the ILEC network in a LATA, which will most often be at the tandem wire center. To avoid over-large transport obligations, there would be at least two interconnection points in each LATA. While interconnection may be at the ILEC tandem wire center, that does not mean that the ILEC should necessarily be required to provide tandem switching. Where the interconnection between the ILEC and another carrier has sufficient traffic volumes, the default rules should require a separate trunk to avoid tandem switch exhaust.

Experience has shown that carriers will offer transit services when they are able to do so profitably. By the same token, there is no need to mandate such services. Indeed, the Commission should not impose any requirements that would decrease a carrier's incentive to provide transit services.

Finally, the Commission should stay the course and let consumers and the industry enjoy the benefits of the CALLS plan. There should be no changes in the access charge regime until

CALLS and MAG have run their course. The Commission previously refused to prescribe access charges, and nothing has happened that should cause it to change its mind.

1. The Near-Term Issues — NXX Misuse and Internet

There are two issues on which the Commission should promptly rule.

A. The Commission Should Eliminate Fraudulent Misuse of Telephone Numbers.

Verizon and others explained that some LECs are misusing telephone numbers to make toll calls look like local calls.[1] This CLEC misuse of number assignments imposes additional transport costs on other carriers; ILEC FX services do not, as the ILEC transports the call to the distant FX customer. The Commission should reject any arguments that this is "just like FX." This scheme is not only inefficient and another flavor of regulatory arbitrage, but it also forces one LEC to provide free service for another LEC in order to allow the second LEC to provide an interexchange service without having to build any facilities of its own. The Commission should make it clear that these arrangements are unlawful.

Some commentors say that there is nothing wrong with these arrangements, as they are just like ILEC FX services.[2] This is not correct. The ILEC providing FX service has a switch in the rate center with which the NXX used to provide the FX service is associated, and it provides local exchange service to customers in that rate center. Calls to an ILEC FX customer are delivered to the ILEC switch, and the ILEC is responsible for transporting the call to the FX customer.

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[1] SBC at 17-18; BellSouth at 7; USTA at 32-34; Michigan Exchange Carrier Assoc. at 45.

[2] Cablevision Lightpath at 6-7; AT&T at 61; Focal at 56; Allegiance at 56.

The same is not the case with the CLEC's so-called "virtual" NXX. As most graphically illustrated in Maine, where the CLEC obtained more than fifty NXX codes for rate centers throughout the state.[3] It had no switch — or any facilities of any type — in any of these rate centers, nor did it offer local service to customers in these rate centers. It did not want other carriers to deliver calls to these NXXs in the rate center with which the NXXs were associated — it had no equipment with which to receive those calls. Rather, it wanted other carriers to deliver calls to these NXXs to its facilities elsewhere in the state, often hundreds of miles away. And it claimed that it had to pay nothing for having other carriers transport its calls for it.

It may be that some CLECs will offer real FX services — that they will receive telephone number assignments for one rate center and occasionally assign numbers from that NXX to customers that are outside that area. All LECs offering such services should be required to assume full financial responsibility for transporting calls from the originating LEC subscriber's local calling area to their remote subscribers. A LEC may satisfy this requirement either by having these calls delivered to it in the local calling area with which the NXX is associated or by paying the originating carrier for transport from that area to the LEC's interconnection point.

Similarly disingenuous are arguments that the only thing that's going on here is CLECs' establishing local calling areas that are different from those of the incumbent.[4] A CLEC may certainly give its customers different local calling areas than the ILEC offers its customers. It could, for example, offer unlimited state-wide flat-rate calling, treating all calls within the state

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[3] *Investigation into Use of Central Office Codes (NXXs) by New England Fiber Communications, LLC d/b/a Brooks Fiber Communications*, Order Requiring Reclamation of NXX and Special ISP Rates by ILECs (Order No. 4), Docket No. 98-758 (Me. P.U.C. June 30, 2000) *available at* www.state.me.us/mpuc/orders/98/98758orr.pdf.

[4] *E.g.,* Cbeyond at 12.

as local. A CLEC's decision to do that, however, does not make a call from the ILEC's customer to the CLEC's customer a local call, subject to all the interconnection and compensation arrangements that apply to local calls.

Focal is more direct. It frankly states that "CLECs should be allowed to define the boundaries of calling areas in which inbound calls would be rated as local just as much as they define boundaries of calling areas in which outbound calls are rated as local."[5] This, of course, would allow a CLEC to establish the local calling area of both the ILEC and other CLECs operating in the area — the very evil that the CLECs accuse the ILECs of trying to perpetrate. It would also undermine decisions by state regulators about what calls should be local and which should be toll for ILEC subscribers and the overall cost-recovery systems adopted by those regulators for the still-heavily-regulated ILEC.

KMC claims that traffic is routed to a "virtual NXX" in exactly the same manner as to any other NXX.[6] But the routing is not the main issue — compensation is. And "virtual NXXs" can be used to hide the nature of the call, where the nature of the call determines the compensation to be paid. Verizon has no objection to routing and delivering calls to a CLEC virtual NXX wherever the CLEC asks; it just wants to be compensated for delivering them outside the local calling area, or for the CLEC to transport the calls, and Verizon does not want to pay compensation based on the supposition that the call is local.

Cbeyond urges the Commission not to address these issues here, but instead to take them up in other proceedings.[7] The Commission has correctly teed up these issues in this docket, as

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[5] Focal at 59.

[6] KMC at 7.

[7] Cbeyond at 13.

they relate, in part, to efforts by some carriers both to avoid paying compensation and to extract intercarrier compensation from other carriers. More important than this docket-pigeonholing, of course, is that these arrangements are resulting in inefficiencies and distortions which should be brought to an end as soon as possible, in whatever proceeding can take them up first.

As Verizon and others also showed,[8] it is inconsistent with existing number assignment principles and rules for carriers to get NXX or number block assignments for use in this way. These arrangements waste increasingly scarce numbering resources, as they encourage LECs to obtain numbers in areas in which they will have no customers. The Commission should put an end to them for this reason as well.

B. The Commission Should Fully Eliminate the Arbitrage on Internet-Bound Calls.

Nothing offered in the comments should change the Commission's conclusion that the extraction of reciprocal compensation for Internet-bound calls is "regulatory arbitrage" that "distorted the economic incentives related to competitive entry into the local exchange and exchange access markets."[9] The Commission should follow through on its policy decision in the *Remand Order* "to address and curtail a pressing problem that has created opportunities for regulatory arbitrage and distorted the operation of competitive markets."[10] The Commission should promptly put this regulatory arbitrage to an end for good.

Allegiance claims that it would be "discriminatory" for the Commission "[t]o create a distinction in what LECs may charge one another for transport and termination based upon the

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[8] Verizon at 8-9; USTA at 33.

[9] *Intercarrier Compensation for ISP-Bound Traffic*, 16 FCC Rcd 9151 at ¶ 2 (2001) ("*Remand Order")*.

[10] *Remand Order* at ¶ 81.

content of the traffic or the identity of the customer receiving the call."[11] In fact, the distinction that exists in the Act and Commission orders is between information access and traffic subject to reciprocal compensation under section 251(b)(5).

Similarly beside the point is the argument made by AOL and others that because the costs of transporting Internet-bound calls do not differ from the costs of transporting local calls, the compensation should be the same.[12] For a variety of reasons, there are often different prices for services or arrangements that have similar costs. The history of abuses concerning compensation of Internet-bound calls provides an ample basis here. Moreover, the record before the Commission included ample evidence that the costs are very different.[13]

AT&T suggests that the problems identified by the Commission could be eliminated by capping compensation for Internet-bound traffic at forward-looking costs.[14] However, this would require CLEC "rate cases" in every state, a result the Commission has consistently striven to avoid.[15] Moreover, the Commission concluded in the *Remand Order* that it was not the rate levels that were the problem, it was the very fact that payments were made. "[T]he market

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[11] Allegiance at 44.

[12] AOL at 2; Ill. Commerce Commission at 2-3.

[13] *Ex parte* letter to Ms. Magalie Roman Salas from Robert T. Blau of BellSouth, CC Docket No. 99-68, dated Feb. 1, 2001, at 2-3 ("... the CLECs average switching costs for dial up traffic works out to about $.0001 per minute or about 1 to 5 percent of current reciprocal compensation rates"); *Ex parte* letter to Ms. Magalie Roman Salas from Gary L. Phillips of SBC Telecommunications, Inc., CC Docket No. 99-68, dated Feb. 16, 2001, at 1 ("significantly less than $.001") and attached Morgan Stanley Dean Witter In Depth Report at page 9, which states that soft-switches can be almost 70% cheaper than circuit-based technology.

[14] AT&T Ordover-Willig Dec. at 23.

[15] *See, e.g., Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, 16 FCC Rcd 9923 (2001).

distortions caused by applying a CPNP regime to ISP-bound traffic cannot be cured by regulators or carriers simply attempting to 'get the rate right.'"[16]

The Commission should now definitively rule that reciprocal compensation is not due on this traffic.

2. The Mid-Term Issue — Section 251(b)(5) Reciprocal Compensation

While promptly resolving these issues, the Commission should also develop a new default plan for section 251(b)(5) intercarrier compensation for local (non-access) calls, both between LECs and between LECs and CMRS providers. Carriers should always be free to negotiate arrangements that make the most sense for them. However, carriers should know what the arrangements will be if they are unable to agree. These default arrangements should be simple and clear. For these calls, this plan should be based on bill and keep arrangements assuming that the Commission establishes clear and equitable default rules as to interconnection points.

A. Properly Structured, Bill and Keep Can Provide Correct Incentives for Efficiency.

The Notice has identified the various problems caused by the existing scheme of intercarrier compensation for local calls.[17] It also correctly notes that a pure bill and keep system could eliminate many of the complexities and issues raised by the existing system.[18] Of course, Verizon pointed out in its comments that any bill and keep system would have to be carefully designed so as not encourage game-playing and arbitrage. The concerns raised by some of the

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16 *Remand Order* ¶ 76.

17 *Notice* at ¶¶ 17, 69.

18 *Notice* at ¶ 52.

commentors about bill and keep, however, do not outweigh the benefits of such a system, if it is properly implemented.

Some parties have argued that a system of bill and keep for local, ISP and CMRS traffic should not be adopted because it would fail to meet various notions of economic optimality. AT&T, for example, offers a statement by economists Ordover and Willig, who dispute the efficiency of bill and keep, arguing instead that the Commission should attempt to determine "perfect" charges for a calling party's network pays regime. Time Warner includes more balanced analyses by Farrell and Hermalin and by Katz and Hermalin, but again suggests that bill and keep is not efficient.[19] In fact, bill and keep for this traffic could provide the Commission with the regulatory approach that is most likely to produce efficient outcomes.[20] To do so, however, the Commission would have to adopt a clear and equitable plan for interconnection points and impose clear financial responsibility on carriers to deliver traffic to those points. With that framework, bill and keep will allow the Commission to pursue its goals through limited regulation of default terms, rather than by attempting to prescribe the "right" price for every inter-carrier transaction.

It is unlikely that end users, when originating calls, are able to take much account of the cost of termination under today's regime. Most local service is not measured, other services (such as CMRS) are sold in "buckets" of minutes, and toll charges are averaged. However, there is another decision that is of crucial importance, and almost entirely ignored by Ordover and Willig, even though it is much more likely to be influenced by the method of intercarrier compensation. Each end user must choose a local carrier. In doing so, that customer should take

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[19] Time Warner at 6.

into account all the costs and benefits, including the carrier's cost of termination. Bill and keep, which requires each carrier to recover its costs from its own end users, ensures that each consumer will "internalize" such cost differences when choosing a carrier.

For the same reason, bill and keep does not establish a price of zero for the exchange of traffic, since each carrier contributes in kind. The challenge is to design a system of defaults that reasonably assigns the cost of transport between the interconnecting carriers.

WorldCom and AT&T both argue that bill and keep would create incentives for ILECs to exercise their "market power" by engaging in pricing behavior designed to disadvantage their competitors.[21] AT&T suggests that this is a reason not to adopt bill and keep; WorldCom proposes default rules which are anything but balanced, justifying them by the need to control ILEC market power.

These concerns are misplaced, and should not influence the decision whether to adopt bill and keep. Any exercise of ILEC market power is constrained in many markets by competition. As explained above, the alignment of end user prices with end user choices in local markets will be improved under bill and keep, thus promoting the development of efficient local competition. In those markets where the Commission remains concerned about market power, it retains the ability to prevent abuse.

More fundamentally, the concerns raised by AT&T and WorldCom are not caused by bill and keep and are, therefore, not reasons to prefer the existing system over bill and keep. First, these parties complain about the effect of bundling a service provided by the ILEC, when a

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[20] Verizon will explain in a later section why the application of bill and keep to access raises very different issues that dictate a different answer.

[21] WorldCom at 25, AT&T at 31.

competing service is provided by another carrier. Second is the use of discounts designed to disadvantage competitors. Both of these arguments are variations of the generic "price squeeze" concern.[22]

The Commission has long recognized that bundling of services into attractive packages creates valuable options for consumers, and that consumers are made better off by having those choices. The objective of policy, therefore, cannot be to eliminate such bundling. Given that bundling exists, the possibility of a price squeeze is the same under bill and keep as it is under the existing system. This is a general issue which has been considered (and rejected as a concern) by the Commission in the past[23], and is not a reason for preferring one system of inter-carrier compensation over another.

The issue of price squeeze in this situation thus does not depend on whether part of the price is charged separately to the end user or built into an end-to-end price. Ordover and Willig admit as much when they say that bill and keep "would not alter the basic economics" of price squeezes.[24] Therefore, vulnerability to price squeezes is not a basis for choosing among regimes. If anything, allowing end users to see clearly the price they are paying for access to other carriers, rather than passing it to an interconnecting network, should allow consumers to evaluate those costs more clearly, and to more effectively police any attempt to discriminate in the application of those charges.

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[22] Ordover and Willig at 27.

[23] *See, e.g., Bell Atlantic New York 271 Order*, 15 FCC Rcd 3953 at ¶¶ 382-3 (1999); *Bell Atlantic New York 271 Reconsideration Order*, 16 FCC Rcd 11457 at ¶¶ 2-3 (2001).

[24] Ordover and Willig at 28.

B. The Commission Should Establish Default Interconnection Points.

Many parties oppose pure bill and keep because COBAK does not establish a limit on how far a carrier must transport traffic. As several commentors have observed,[25] it is unreasonable for one carrier to have to transport traffic hundreds of miles simply because another carrier chooses a distant location for its switch. This suggests a geographic limit on the obligation to deliver traffic, and some commentors have offered different rules to apply such a limit.[26]

The default rules should ensure that the division of transport costs is symmetrical and not penalize any class of carrier. At the same time, each carrier should pay for the results of its own choices with respect to network design. If one carrier chooses more costly switches, then the cost of that choice should be reflected in rates paid by that carrier's end user customers. Similarly, there might be a choice in network design between switching and transport. A choice to have fewer switches may involve higher transport costs, and those costs should also be borne by that carrier's end users. Any residual concerns over market power should be dealt with by making the obligations symmetrical, not through imposing punitive restrictions on ILECs or by assigning asymmetric default rights to one party, as WorldCom proposes.[27]

As Verizon and other parties have noted,[28] a new framework of intercarrier compensation should not ignore the facility arrangements that already exist. These arrangements represent

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[25] BellSouth at 14.

[26] *E.g.*, Sprint at 31.

[27] WorldCom at 25-26.

[28] BellSouth at 13, n.19.

significant investments, and any new default rules should not arbitrarily devalue these investments.

Verizon, therefore, proposes a framework for the definition of default responsibility that reasonably balances the concerns raised in the comments. This proposal is a significant compromise in that it would have ILECs allow connecting carriers the benefit of connecting to a multi-tiered network without the financial responsibility to deliver to individual end offices. This proposal would make bill and keep a workable compensation solution for interconnection of local and CMRS traffic.

i. New rules should create equitable transport obligations.

Today, ILEC tandem wire centers are logical locations to serve as interconnection points, and the default rule should be based on the expectation that interconnection with ILECs will take place at those locations. First, tandem wire centers are widely used for this purpose already. Thus, using tandem wire centers as interconnection points would allow investments in existing interconnection arrangements — by ILECs and other carriers — to continue to be used. The number of points of interconnection would be reduced, meeting a concern raised by several parties. If a CLEC's obligation to deliver traffic were to end at the tandem wire center, it would be relieved of having to pay for transport between the tandem and each end office, and the cost of this transport would be borne by the ILEC.

Because almost all carriers interconnect with the ILECs, and the largest traffic flows are those to and from the ILECs, each ILEC should designate at least two interconnection points in each LATA. These interconnection points should generally be established at the highest level of switching in the ILEC's network hierarchy within each LATA. Other carriers would use these

points of interconnection to interconnect with the ILEC. For direct interconnection with one another, non-ILECs would designate additional interconnection points.

As shown on the attached diagram, this default interconnection point would be located at the ILEC's highest point of switching in the LATA. Under today's ILEC network architecture and prevalent installed switching technology, this point would be at tandem switching center locations. In LATAs that have multiple highest points of switching, the ILEC could designate each as an interconnection point, with connecting carriers delivering traffic to the interconnection point that serves the wire center where the call is destined.[29] In those LATAs where the ILEC's serving area has fewer than two such points, the ILEC would designate additional interconnection points to ensure that there are at least two interconnection points in each LATA. This would provide a reasonable balance of transport obligations on both carriers exchanging traffic. These additional interconnection points might be at a facility hub wire center or other similar point in the ILEC's network.[30] ILECs that do not have tandems in their serving areas may designate other suitable locations as their interconnection points.[31]

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[29] Within their networks, carriers interconnecting with ILECs would be obligated to identify traffic destined for ILEC Numbering Plan Area ("NPA")/NXXs assigned to end offices subtending a particular tandem and to deliver that traffic to the interconnection point at that tandem wire center When the interconnecting carrier has multiple highest points of switching within a LATA, there would be a symmetric obligation for the ILEC to identify traffic destined for NPA/NXXs associated with each of those highest points of switching and to deliver that traffic to the appropriate interconnection points. These symmetric obligations would avoid inefficient inter-tandem switching and/or transport on either network.

[30] As new technologies, such as voice over ATM are deployed, a network "edge" gateway device could serve as the interconnection point and the access point to the core ATM switch.

[31] For example, if an ILEC had a number of stand-alone end offices, one end office could be designated as an interconnection point. From this point, the ILEC would be obligated to provide transport to other stand-alone end offices and to provide a tandem-like switching function and associated transport upon request.

All carriers exchanging traffic with an ILEC would be responsible for getting traffic to and carrying traffic from the interconnection point. They could satisfy this responsibility either by using their own facilities for this transport or buying it from another carrier. Thus, for example, the ILEC would be responsible for all transport between the interconnection point and the end office serving the ILEC customer, for local switching at the end office and for tandem switching of traffic below a specified threshold. This obligation would apply to both originating and terminating traffic. Similarly, any interconnecting carrier would be responsible, in both directions, for all transport on its side of the interconnection point and for any other network elements required to carry the traffic to or from its end user. These would be default obligations, and carriers would be free to negotiate different arrangements.

For direct interconnection with one another, non-ILEC carriers would establish additional interconnection points at locations that contain the highest level of switching in each carrier's network. CLECs often state that their networks are not designed in the same tandem/end office topology used by ILECs. To avoid that concern, each carrier would establish at least one such interconnection point in each LATA where it exchanges traffic with a carrier other than an ILEC.

If the traffic destined for a specific end office subtending the tandem exchanged between the ILEC and another carrier at the interconnection point is less than a threshold of the equivalent of one DS-1, this traffic could be routed through the ILEC tandem switch, at the option of the interconnecting carrier. The cost of this tandem switching would be borne by the ILEC. This would allow carriers with small volumes of traffic destined for a specific end office subtending the tandem to achieve greater trunking efficiencies by taking advantage of the aggregating function provided by the tandem. However, when the traffic at the interconnection point destined for a specific end office subtending the tandem is greater than a threshold of one

DS-1, it is no longer economical for the ILEC to have the traffic switch through the tandem, nor is it reasonable for the ILEC to be required to provide this function. Interconnecting carriers must, therefore, have the default obligation to provide for direct trunking of this traffic.[32] This default direct trunking obligation would be symmetric in that the interconnecting party would have an obligation to accept direct trunking at the interconnection point from the ILEC when originating traffic from a specific end office subtending the tandem destined for the interconnecting carrier exceeds the DS-1 threshold. However, either carrier using direct trunking would still retain the option of using the tandem for overflow traffic from its direct trunks, so long as the amount of overflow did not exceed the threshold of the equivalent of one DS-1. This option would help all involved manage the use of their direct trunks efficiently, in much the same way that IXCs use direct and tandem-routed transport for long distance traffic.

This default rule would still allow LECs to agree to interconnect at fewer points, such as one point per LATA as some commentors want.[33] However, it does mean that carriers which choose such arrangements would be responsible for paying for the additional transport. This is consistent with what the Commission has held all along. For example, in the *Local Competition*

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[32] In this context, "direct trunking" does not mean, as it does in the context of interstate access, that the interconnecting carrier must provide or pay for a separate transport route to the end office. The interconnecting party would present the traffic at the interconnection point, and the ILEC would still be responsible for transport from the interconnection point to the end office. "Direct trunking" in this context means simply that the traffic is exchanged at the interconnection point (or at another point mutually agreed to, such as the end office), but is not switched through the tandem. In order to make this routing possible, the interconnecting carrier would be required to sort the traffic at its own switch, so that the traffic bound for each end office would be segregated on specific circuits which the ILEC could then directly connect to its own transport to that office.

[33] *E.g.*, Cbeyond at 8; Focal at 54; Level3 at 20; Time Warner at 15; WorldCom at 22.

Order, the Commission held that a CLEC that desires "a 'technically feasible' but expensive interconnection would, pursuant to section 252(d)(1), be required to bear the cost of that interconnection, including a reasonable profit."[34] This "pay or carry" approach will give these carriers the incentives to make rational choices that promote economic efficiency.

Where carriers pass SS7 signaling to each other, they must also designate interconnection points for their SS7 networks. This is because SS7 signaling is carried over different facilities than the voice or other content of the telephone call. Signaling Transfer Points, or STPs, are the devices carriers use to switch and route SS7 signaling traffic. Verizon proposes that, where the interconnecting carriers both have their own STPs, ISDN User Part ("ISUP") call setup signaling traffic for local calls should be exchanged on a bill and keep basis. If one interconnecting carrier does not have an STP, but relies on STP functionality provided by the other party, then the carrier providing the STP functionality should be permitted to charge for that service. Existing arrangements and pricing would continue for other uses of SS7 functionality, such as database inquiries, unless the parties voluntarily agree otherwise.

Each carrier would be responsible for transport to the other carrier's STP. Today, some carriers do not wish to provide their own transport to every ILEC STP. Verizon and other providers offer STP gateway and transport services to meet those needs. Verizon's service allows the interconnecting carrier to bring its signaling to a central Verizon STP, which then serves as a hub for reaching other Verizon STPs, using Verizon's transport.[35] ILECs could

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[34] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 at ¶ 199 (1996) ("*Local Competition Order")*.

[35] The STPs which serve as gateways are set forth in Verizon's tariffs. Sections 271(g)(5) and (6) of the Act impose certain limitations on the uses of this service.

continue to offer such services within a new bill and keep framework. This would allow an interconnecting carrier to meet its default obligations by bringing its signaling traffic to an ILEC gateway, and by purchasing the gateway service at the tariffed rates. Because the exchange of SS7 ISUP traffic would still take place on a bill and keep basis when the gateway option is used, there would be no usage charge for the use of the SS7 functionality, although there may be port and transport charges associated with the gateway service itself.

This system offers significant advantages. It provides a reasonable distribution of the transport obligations between the parties by balancing limiting the distance any carrier must transport traffic and limiting the number of interconnection points to which traffic must be delivered. It defines the default obligation to deliver traffic without reference to any particular technology or network design, which will provide neutrality with respect to different technologies, minimize unnecessary disputes and avoid creating artificial incentives for inefficient network designs.

Other proposals should be rejected. Cbeyond asks that the Commission require ILECs to provide meet point interconnection at CLEC request.[36] While carriers should be permitted to use meet point arrangements if mutually agreeable, the Act does not require them because such a location is not a "point within the carrier's network."[37]

ii. New rules should minimize opportunities for manipulation.

The Verizon proposal also addresses some of the concerns raised about adverse incentives that might be created under bill and keep for section 251 (b)(5) traffic.

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[36] Cbeyond at 11.

[37] 47 U.S.C. § 251(c)(2)(B).

One concern expressed by several parties is the possibility that each carrier may attempt to assign as much transport cost to interconnecting carriers as possible by manipulating the placement of interconnection points. Farrell and Hermalin refer to this in the context of COBAK as "moving central offices."[38] Verizon's proposal addresses this concern by defining a very limited number of interconnection points, by associating them with the highest point of switching in each network, and in the ILECs, with tandem locations that are already well known and widely used. Because there is a two-way interconnection point for exchange of traffic with the ILEC, no carrier can gain an advantage by designating some other location as an "end office."

Another concern is that a carrier might design its network to place interconnection points on or near the premises of its customers, in order to obligate other carriers to deliver traffic to those customers. The framework proposed here would make such strategies more difficult. Even for the exchange of traffic among non-ILEC carriers, in order to designate multiple interconnection points in a LATA, it would be necessary to form a new entity for each interconnection point, which would be costly and inefficient.

A final concern raised with bill and keep is that end users would try to masquerade as carriers for all or part of their traffic. Any system that treats end users and carriers differently will have some exposure to such game-playing, and the Commission should make full use of its enforcement authority to end such abuses where they occur. The framework proposed here, however, would tend to limit the potential gains from such a strategy and would thereby

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[38] Farrell and Hermalin at 8: "If bill and keep is imposed, each carrier has an incentive to "dump" traffic on another carrier as soon as possible, and to accept it as late as possible. It seems inevitable that COBAK would create 'regulatory arbitrage' incentives to locate 'central offices' as far out in the network as possible."

discourage such activity in the first place. An end user that poses as a carrier would take on a two-way obligation to deliver its traffic to and from an interconnection point. There would be no opportunity to split the end user's originating traffic from its terminating traffic, or to induce other carriers to deliver traffic to the end-user's location.

iii. Service quality will not be adversely affected.

WorldCom suggests that an ILEC would have the incentive and the ability to impose costs on its local competitors by selectively reducing the quality of traffic exchanged with those competitors.[39] In fact, WorldCom's concerns are answered by Verizon's interconnection proposal.

For local, ISP-bound and CMRS traffic, the originating customer has a retail relationship with a local carrier and will most likely perceive any degradation of outgoing calls as a problem with that carrier's service. The relevant question then becomes whether it is reasonable to conclude that an ILEC could selectively reduce the quality of calls terminated from other networks, without simultaneously affecting the quality perceived by its own customers on originating calls. To answer this question, it is useful to consider the alternative arrangements for terminating traffic under Verizon's proposal.

First, for traffic below the threshold of one DS-1 that Verizon has proposed, traffic could be routed through an access tandem. These calls would then be carried from the tandem to the end office over trunks that are used to carry other traffic, including that of the ILEC's own customers. The ILEC could not degrade quality on these trunks without affecting its own originating traffic.

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[39] WorldCom at 25.

Second, once the threshold level is reached, some traffic would be delivered over direct trunks and not switched at the tandem. If the ILEC also has originating traffic from that end office bound for the other carrier, it is usually advantageous for both parties to agree on a shared, two-way direct trunk. In this case, it would again be impossible for the ILEC to degrade quality without affecting its own originating traffic.

Third, there may be instances where a shared direct trunk group has not been agreed upon. In those cases, under Verizon's proposal, the interconnecting carrier would deliver traffic to Verizon's interconnection point over groomed, one-way trunks, which Verizon would then transport to its end offices. However, for any direct trunking, whether one-way or two-way, Verizon's proposal maintains the option of overflowing traffic to the ILEC tandem. There would be strong incentives for an interconnecting carrier to make use of this option, since it would allow more efficient use of its direct trunks. Given this arrangement of direct trunking with overflow to the tandem, any effort by either carrier to under-provision the direct trunk group on its side of the interconnection point would be counterproductive. If the interconnecting carrier provided too few direct trunks, the amount of overflow would exceed the allowed limit, and the ILEC would be able to demand that the trunking be increased until the overflow was below the DS-1 threshold. If the ILEC provided too few trunks on its side of the interconnection point, this again would simply cause more overflow to the tandem. There would be no selective degradation of the other carrier's traffic, since the final grade of service seen by the interconnecting carrier would be determined at the margin by the tandem-routed traffic, and once again the ILEC could not reduce this level of quality without affecting its own customers. Further, the ILEC, by creating this overflow, would generate additional tandem switching costs for itself, and further exacerbate the problem of tandem loading that several ILECs have

emphasized in their comments. Thus, the design for bill and keep Verizon has proposed will tend to be self-correcting, with the level of overflow to the tandem serving as a "relief valve" and indicating the need for additional trunking from one or the other of the interconnecting parties.[40]

In summary, there is no reason to expect that an ILEC could selectively reduce the quality of the service perceived by the customers of another, interconnecting local carrier. Any attempt to do so would be self-defeating, since it would affect the ILEC's own customers, and in some cases impose additional costs on the ILEC as well.

C. Alternatives to Bill And Keep for Non-Access Traffic Should be Based on "Additional Costs," not a Prescribed Model.

Ordover and Willig suggest that any evils of the current regime can be cured simply by prescribing the "properly cost based" rate for each intercarrier transaction.[41] This is precisely the wrong direction for the Commission to go, particularly in light of the level of competition in the industry and the goals of Telecommunications Act to reduce regulation and place greater reliance on competition.

Hermalin and Katz show that models of intercarrier pricing are extraordinarily complex, and they must make restrictive assumptions and omit important considerations in order to solve their models.[42] Finally, the detailed information necessary to use any of their models solutions, such as elasticities and marginal costs, are not readily available to the Commission, and any effort to approximate them would involve years of proceedings and litigation, create uncertainty

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[40] Incentives are different in the case of originating interexchange access, since the end user may have a separate retail relationship with the IXC. This is another reason why the considerations surrounding bill and keep for access are fundamentally different from those affecting ISP-bound, local, and CMRS traffic.

[41] Ordover and Willig at 5.

for all the parties, as well as for the capital markets on which they all depend for funding, and provide ample opportunities for rent-seeking behavior by parties seeking to influence the prescribed rates.

The Commission should certainly not use a TELRIC methodology to set intercarrier compensation prices for local calls because TELRIC pricing has several substantial disadvantages in terms of the incentives it provides to both incumbent local exchange carriers and new entrants.

TELRIC does not capture the actual "additional costs of terminating a local call" as specified in the Act.[43] Instead, TELRIC as interpreted by the Commission captures the forward-looking costs of a hypothetically efficient firm.

TELRIC by definition identifies the cost of all usage and as such is at odds with the Act's requirement to price reciprocal compensation based on the specific cost "of calls that originate on the network facilities of the other carrier."[44] Also TELRIC theoretically provides the total cost of providing an element. This again is inconsistent with the Act's specification of the use of "additional cost." TELRIC looks at the cost of building a network from scratch and uses as its demand the total of all demand from all services. The "additional cost" standard, however, looks at things differently.

Additional cost is by definition the "added" cost of providing service. An average incremental cost calculation could be used to determine such an amount. This requirement is

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[42] For example, Hermalin and Katz at 5-9 and Farrell and Katz at 2: "The overall problem, blending short-run and this somewhat nuanced longer-run analysis, is far more complex than even the Hermalin-Katz upgrade of Dr. DeGraba's analysis."

[43] 47 U.S.C. § 252(d)(2)(A)(ii).

[44] 47 U.S.C. § 252(c)(2)(A)(i).

fundamentally different from other cost standards in the Act and rightly so. Access charges, for example, are a service, with "just and reasonable" rate requirement. There, a long distance carrier is using the local network as a component of its own service. In contrast, for local and CMRS interconnection, there are independent networks that need to interconnect to provide full communication value for their own customers. They are not using the other network for their own service, but rather to allow a customer to complete a call outside their own network. As explained in the attached declaration of Professor Howard Shelanski, there is "no reason that the economics of local interconnection should be assumed identical to those of the very different relationship inherent in long distance access."[45] Of course, if transport is apportioned fairly, as it is under Verizon's proposal, there is no need to have any exchange of payments in such a situation.

If payment is retained and if some form of TELRIC is adopted — a result Verizon does not support — then the Commission should rule that the ILEC price is presumptively the ceiling for other carriers' compensation rates. The ILEC has the largest, most dispersed network, deployed over many years in ways that might not be the most efficient if the ILEC were starting from scratch today (as most other carriers are). These other carriers should not be allowed to charge a price higher than the ILEC's without demonstrating that the price is necessary to allow it to recover its "additional costs of terminating a local call."

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[45] Shelanski Declaration ¶ 1.

D. The Act Does Not Require ILECs To Provide Transit Services for Other LECs.

Some commentors claim that the Commission has authority under sections 201 and 251 to require ILECs to provide transit services, and to provide them at TELRIC-based rates.[46] There is no such obligation, and there certainly is no basis for using TELRIC.

Transit service is a service provided by one carrier, often the ILEC, to facilitate the interconnection of the other carriers' networks where those carriers do no interconnect directly with each other. The service allows the other carriers to terminate traffic on each others' networks without directly connecting with each other. Transit service does not involve the origination or termination of traffic to customers of the transiting carrier.

There is no reason that these two carriers cannot interconnect directly and negotiate interconnection arrangements between themselves. Section 251(a)(1) of the Act, of course, imposes on all carriers an obligation to interconnect. Therefore, if one of the commentors wants to deliver traffic to customers of another LEC, it can simply interconnect directly with that other carrier, and the other carrier is required to do so.

While Verizon is required to interconnect with a CLEC to accept CLEC-originated local traffic that is to be delivered to Verizon's end-user customers, nothing in the Act requires Verizon to accept any CLEC traffic that is destined for another carrier (such as another CLEC or a non-Verizon ILEC). Section 251 requires carriers to "interconnect" with each other. The Commission has interpreted this term to mean "the linking of two networks for the mutual exchange of traffic."[47] In a transit situation, Verizon as the transiting carrier is not exchanging

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[46] AT&T at 10, 62; Sprint at 33; Triton PCS at 13.

[47] 47 C.F.R. § 51.5.

traffic with either of the two other carriers — it is simply facilitating the exchange of traffic, or the interconnection, of those carriers.

And, of course, Verizon would not be required to pay reciprocal compensation if it did handle this transit traffic. Section 252(d)(2)(A)(i) states that reciprocal compensation shall provide for the recovery by each carrier "of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier . . ." A call from a customer of LEC A to a customer of LEC B originates on LEC A's network and terminates on LEC B's network. If these carriers use Verizon to facilitate their interconnection, that does not mean that this call "originates" on Verizon's network facilities. Because this transit traffic does not originate on Verizon's network, there can be no reciprocal compensation obligation. This is the conclusion the Commission reached in an analogous situation in *TSR Wireless LLC v. U.S. West Communications, Inc*., where the Commission held that transit traffic was not an interconnection service for which UNE pricing was appropriate.[48]

The New York commission recently rejected a similar argument by AT&T. In that proceeding, the New York commission flatly held, "The Commission finds that Verizon is not obligated to provide transit service for the exchange of traffic between AT&T and other carriers."[49] The Commission should reach the same conclusion.

The fact is that carriers will offer transit services where it is economical for them to do so, even where a regulator does not require it. This is proven by the fact that Verizon voluntarily

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[48] 15 FCC Rcd 11166 at n.70 (2000).

[49] *Joint Petition of AT&T Communications of New York, TCG New York and ACC Telecom for Arbitration to Establish and Interconnection Agreement with Verizon New York,* Case 01-C-0095 at 42 (N.Y. P.S.C. July 30, 2001*).*

provides these services today in many areas. Verizon offers transit services and tandem switching of transit traffic up to DS-1 capacity at rates equivalent to those in the interconnection agreements. As explained above in connection with points of interconnection, the DS1 limitation is reasonable to limit traffic congestion and tandem exhaust. Limiting congestion at the ILEC's tandems benefits all users of the public switched telephone network.

If there is no limitation on the level of transit traffic, then the two carriers would have no incentive to interconnect directly with each other. The ILEC would be obligated to provide this service in perpetuity because the two carriers would never have to negotiate with each other, provision their own facilities to collect and receive traffic from carriers other than the ILEC or directly bill one another. Once the traffic volumes reach a DS-1 level, however, there is no reason for the ILEC to continue to provide transit services. At this level, the traffic between the two carriers is sufficient to justify a direct interconnection trunk for their traffic. For traffic levels above DS-1, CLECs may self-supply or purchase transit services as special access offerings from ILECs or other network providers.

Transit services should be subject to minimal or no regulation, given that the ILEC is offering the service as a third party vendor. Further, the services would be available in the market at market-based prices. Should the Commission decide that a level of regulation is necessary, transit services should be regulated as any other state or interstate service. The pricing standards, rules and regulations in place for the jurisdiction in which the service is offered would be applicable for the transit offering.

3. Long-Term Issue — Stay the Course on Access and Toll Calls

Finally, when these issues have been resolved, the Commission should consider what, if any, changes should be made to its access charge system for intercarrier compensation for toll calls.

A. Continue the CALLS Plan.

The Commission got it right when it said that the relevant question was, "What comes after CALLS?,"[50] and nothing that's been filed suggests otherwise.[51] The CALLS plan took effect only a year ago and will last until mid-2005. It establishes interstate access rate levels and an aggregate amount of interstate universal service support for 97 percent of the interstate access traffic. There should be no changes in the CALLS plan until 2005. Similarly, the Commission has announced the adoption of the "MAG" plan for non-price cap LECs. It too should be allowed to run its course before major structural changes are made.

Nothing that has been filed suggests that the Commission should now deviate from its plan for the CALLS plan to provide a five-year period of stability in the access rules — "the CALLS Proposal provides stability during its term and addresses several issues that have served as major obstacles to access charge reform and universal service."[52] This will allow both LECs and interexchange carriers to plan more effectively and to put an end to the arguments over access rates that had occupied so many resources since 1990. AT&T, one of the proponents of

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[50] *Notice* at ¶ 97.

[51] The fact that certain aspects of CALLS have been remanded to the Commission does not change the fact that CALLS established a comprehensive five-year plan for the pricing of the overwhelming majority of all the interstate access services provided in the country or provide any basis for setting a new course in mid stream.

[52] *CALLS Order*, 15 FCC Rcd 12962 at ¶ 35 (2000).

TELRIC-based access charges today, touted this as one of the benefits of CALLS, telling the Commission:

> "The CALLS Plan provides reasonable solutions to each of these important issues, solutions that will also produce a stable, predictable regulatory environment conducive to making the investments necessary for competition. That in itself is an important public interest benefit of the CALLS Plan."[53]

Most important, nothing that has been filed suggests that the public would benefit from an elimination of the access charge regime and an untimely scrapping of CALLS. CALLS is plainly in the public interest — "We therefore find the CALLS Proposal to be in the public interest"[54] — and should be allowed to run its course.

By contrast, the comments do show that the Commission would have to resolve numerous issues and make fundamental changes in its existing rules before such a change could be made. The states would also have to buy into the new plan and resolve issues consistent with the Commission's plan; many of the possible benefits of a bill and keep system — simplicity, reduction of administrative burden, etc. — would be lost if there were inconsistent federal and state intercarrier compensation regimes. Before the Commission decides that it will abandon the existing per minute access charge regime in favor of a unified bill and keep regime, it would be important to understand how that will affect intrastate regulation. Will it create untenable arbitrage opportunities? Will it create inefficient regulation to prevent arbitrage? Will it force changes in other regulations? Answering the likely interaction effects of proposed changes is important to understanding the efficiency effects of proposed rule changes.

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[53] *Access Charge Reform Notice of Proposed Rulemaking*, AT&T Comments at 20, dated November 12, 1999.

[54] *CALLS Order* ¶ 35.

In addition, if LECs cannot collect $11 billion annually in interstate access charges from interexchange carriers — revenues are used to cover these carriers' costs of providing service — the Commission must provide the opportunity for LECs to recover them from other sources. These twin requirements might not be easy to achieve.

B. Don't Prescribe Access Rates.

Some of the commenting interexchange carriers argue that TELRIC or some other theoretical forward looking cost models should be the basis of any new access charge regime.[55] The Commission rejected such requests before for good reasons. First, the Commission found that "accurate forward-looking cost models are not available at the present time to determine the economic cost of providing access service" and that "[b]ecause of the existence of significant joint and common costs, the development of reliable cost models may take a year or more to complete." This is still true today. The Commission was also "concerned" that any "dramatic cuts in access charges" "could result in a substantial decrease in revenue for incumbent LECs, which could prove highly disruptive to business operations," concerns that still exist. Finally, it is still true that "precipitous action could lead to significant errors in the level of access charge reductions necessary to reach competitive levels [which] would further impede the development of competition in the local markets and disrupt existing services."[56] These conclusions were supported by substantial factual evidence and economic opinion, and nothing has occurred that should cause the Commission to change its mind.

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[55] AT&T at 16-17; WorldCom at 23.

[56] *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd 15982, at ¶¶ 45-46 (1997).

The TELRIC approach is also totally inconsistent with the Commission's policy direction over the past decade to move away from cost-based regulation and its establishment of price caps as the regulatory regime for interstate access charges. As Professor Shelanski explains, "the Commission should be seeking ways to make regulation less prescriptive, and less information-intensive."[57] Indeed, the Commission has begun the process of removing price regulation as competition grows. Any rate prescription now would be an abrupt change of course and would disrupt that growth. The Commission should not make such a fundamental course change now.

Substituting TELRIC for CALLS would be the worst of both worlds. It would continue everything that is bad about the existing regime — heavy regulatory involvement, cumbersome recordkeeping and complexity. In fact, it even enlarges these evils by requiring new TELRIC-based cost studies and a system of rules that is far more complicated than that required by price caps and CALLS. At the same time, the rates this new system would produce would not provide incentives for economically efficient choices by consumers and carriers, a requirement of any pricing scheme. If there is to be an access charge system, then, those charges should generate revenues sufficient to recover the costs of the carrier's actual network, as these are the only costs that send correct price signals to the market, and not be based on the forward-looking costs of a purely hypothetical carrier that always uses throughout its network the most up-to-date technology deployed in the most efficient network configuration.[58] This is because access charges that are below costs could prevent entry by efficient facilities-based carriers because they would be competing with a firm required to charge prices below cost.

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[57] Shelanski Declaration ¶ 4.

[58] *Local Competition Order* at ¶¶ 679, 683-685.

TELRIC as applied by the Commission does not permit carriers to recover the costs of their networks.[59] Moreover, using TELRIC would be inappropriate even if the Commission utilized a different forward-looking cost model, such as one that is not based on the hypothetical network. Carriers spent real money over a period of years to construct the facilities used to provide access transport and switching services, and prices must be set to allow carriers to recover these real world costs. Any cost standard that ignores real costs would skew the competitive marketplace and cause inefficient behavior. For example, model-based rates would stifle competition in the access services market, as low model-based access rates would turn away potential entrants into the market. Commission action that would serve to dampen competitive entry into the access market would hardly "provide incentives for competitors to ultimately offer more of their own facilities."[60]

It was the Commission's express goal in adopting TELRIC to produce dramatically *lower* prices than would be dictated by either a measure of a carrier's actual forward looking costs or its historical costs.[61] If applied to access, such a shift would be bad policy in that it would undermine future ILEC investment and, by underpricing the existing network, it would discourage competing investment as well. Moreover, under the constitutional test set forth in *Duquesne Light Co. v. Barasch*, a new regulatory regime is unlawful if the new rates are not within the "range of reasonableness" based on the prior regime.[62] TELRIC cannot pass this test.

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[59] *See* Shelanski Declaration ¶ 5.

[60] Michael K. Powell, *Digital Broadband Migration Part II*, Press Conference, October 23, 2001, at 3, *available at* http://www.fcc.gov/Speeches/Powell/2001/spmkp109.html.

[61] *Local Competition Order* at ¶ 706 (historical costs would require Aincreasing the rates for interconnection and unbundled elements").

[62] 488 U.S. 299 at 312 (1988).

C. Don't Adopt Bill and Keep for Access Now.

Likewise, there is virtually no support from affected parties for using bill and keep for access at this time. Local exchange carriers oppose it,[63] as do state regulators[64] and most of the interexchange carriers.[65]

As discussed above, there are fundamental differences between establishing bill and keep for local and CMRS interconnection and doing so for access. Under the current regime, long distance access is an input to service provided by the long distance carrier. Thus, local interconnection is a "reciprocal compensation relationship of termination services between carriers, whereas long-distance service is a vertical relationship in which local termination is just an input into the long-distance carrier's provision of calling services to end users. There is no reason that the economics of local interconnection should be assumed identical to those of the very different relationship inherent in long distance access."[66]

As virtually everyone recognizes, using bill and keep for access would require a fundamental restructuring of the way local telephone companies recover their costs, both at the interstate and intrastate levels. Costs that are now recovered from long distance companies through access charges would, presumably, be recovered from the local company's end user customers. These changes cannot be accomplished over night and would require the coordinated efforts of the Commission and the states.

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63 SBC at 24; USTA at 22; NECA at 17; Michigan Exchange Carrier Assoc. at 8.

64 *E.g.*, Alaska at 2; California at 6; Florida at 5 ; Iowa at 3; Maryland at 13.

65 AT&T at 47; Sprint at 22.

66 Shelanski Declaration ¶ 1.

WorldCom seems to be the only affected entity that has any interest in bill and keep for access.[67] However, WorldCom's own comments highlight some of the new issues bill and keep would raise. WorldCom proposes that if there were a shift to bill and keep for access charges that the interexchange carrier should get to choose the quality of the trunk and monitor the quality.[68] This proposal, of course, would provide incentive and ability for interexchange carriers to shift costs to LECs and to demand "Rolls Royce" quality trunks or to use inefficient trunks that benefit the interexchange carrier.

WorldCom proposes that the Commission, should it decide to adopt bill and keep for access,

> "should also adopt rules to prevent incumbent LECs from routing originating traffic over facilities other than those used by the IXC to route its terminating traffic. One such rule, as an example, could require that while IXCs determine how traffic will be routed, incumbent LECs are responsible for a pro-rata share of the costs of the facilities selected by the IXC based on the proportion of originating minutes to terminating minutes."[69]

This would place all the control in the hands of the interexchange carriers. These carriers could completely determine routing and pay only a miniscule portion of the costs if the area were one that originated a large number of calls. The interexchange carrier would have little incentive to pick a cost minimizing routing because the cost of additional capacity would be borne disproportionately by the LEC.

The Commission should reject substituting bill and keep for access charges at this time.

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[67] WorldCom at 9-13.

[68] WorldCom at 25-26.

[69] WorldCom at 25-26.

Conclusion

The Commission should promptly deal with the issues that need immediate attention, move to adopt Verizon equitable interconnection proposal for local and CMRS traffic, and carefully work through the much larger issues raised by any wholesale change in compensation mechanisms.

Respectfully submitted,

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Edward Shakin
John M. Goodman

Attorneys for the Verizon
telephone companies

Michael E. Glover
Of Counsel

1300 I Street, N.W.
Washington, D.C. 20005
(202) 515-2563

Dated: November 5, 2001